STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2011 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 10(B): TAXATION

(JUNE 2011)

TIME ALLOWED: 3 HOURS

SUGGESTED SOLUTIONS

SECTION A

ANSWER BOTH QUESTIONS IN THIS SECTION

1. (a) (i) Mr Khangamwa's Taxable Income Tax Year to 30 June 2010

		K'000	K'000
Profit before tax			18,750
Add back:			
Withholding tax on interest		62.50	
Donations to local church		75	
Private motoring			
- Fuel and lubricants		276	
- Road permits and licences		22.5	
- Vehicle maintenance		375	
-			
Penalties and fines			
- Late submission of tax return		37	
- Traffic offence fine		33	
Legal expenses		20	
Depreciation		560	1,521
Fringe Benefits Tax		60	20,271
Interest	(10)		625
Less: Capital allowances	625		19,636

Notes for Markers

Workings under note 1 (not additional marks)

Determination of withholding tax on bank interest:

Net interest recorded : K250,000

Rate of withholding tax 20%

Grossing up = $\frac{250,000}{80}$ x 100

Gross interest = 312,500

Less interest = 250,000 ½ interest 62,500

1. Under Note 3 K,000

Determination of private motoring:

(1) Fuels and lubricants

Total cost : 920,000

30% there on : $\frac{920 \times 30}{100}$

= 276,000

2. Road permits and licences

Total cost	:	75,000
30% thereon	:	$\frac{75,000}{100} \times 30$
	=	22,500

3. Vehicle maintenance

Total cost	:	1,250,000
30% thereon	:	$\frac{1,250,000}{100} \times 30$
	=	375,000

(ii) Computation of net tax payable

Tax payable on K19,636,000				
1st	120,000	@ 0%	=	0 ½
Next	36,000	@ 15%	=	5,400 ½
Balance	19,480,000	@ 30%	=	5,844,000 ½
				5,849,400
Total tax as above				5,849,400

Less: Withholding tax on interest	62,500 ½	
Withholding tax on rent	35,000 ½	
Provisional tax	1,450,000 ½	1,547,500
		4,301,900

(b) The donation to local church is disallowed because the local church is not approved according to the Taxation Act.

(c) Declaration of a company's county of incorporation is significant because the Malawi tax law imposes an additional tax of 5% on companies that are externally incorporated.
The declaration therefore helps the Revenue Authorities decide on whether to impose the additional tax or not.

2. Computation of capital allowances – Year to 30/06/09

	Factory Building	Plant & Machinery	Motor Vehicles	Furniture & Fittings
	K'000	K'000	K'000	K'000
WDV 30/6/09	7,600	5,200	2,700	940
Less: disposals	-	(1,870)	-	-
	7,600	3,330	2,700	940
Additions	2,900	2,200	6,400	750
	10,500	5,530	9,100	1,690
Less: investment allowance	(2,900)	(2,200)	-	-
				(150)
Less: Initial allowance	-	-	-	(169)
Less : Annual allowance	(380)	(333)	(1,820)	1,371
	7,220	2,997	7,280	

Notes for markers

The following are not additional marks but for noting.

(1) Factory building

		K
Additions are made up of fencing:		1,400
offices :		1,500
		2,900
Investment allowance at 100%	=	1,400
		1,500
		2,900

(2) Plant and machinery

	K'000
Proceeds	1,700
Gain	250
WDV	1,450 +
TWDV for scrap	420
Total TWDV	1,870

(3) Motor vehicles

Additions are made up of two vehicles

	K'000
Saloon	2,200
Double cabin pickup	4,200
	6,400

(b) Why capital allowances are claimed in respect of fencing and offices.

Fencing

Fencing of an industrial building is deemed to be an essential protective fencing and as such, such fencing becomes part of industrial building and therefore eligible for capital allowances.

Offices

Expenditure in respect of offices is eligible for capital allowances because:

- offices are attached to the factory building and therefore part of the industrial building; and

- the expenditure in respect of the offices is less than 20% of the cost of the whole structure, factory building includes offices.

Proof

Original cost of the factory building		K12,000,000
Additions :	fencing	1,400,000
	offices	1,500,000
		14,900,000

Proportion of expenditure in respect of offices to the expenditure of the whole structure:

$$\frac{1,500,000}{14,900,000} \times 100$$

$$= 10.07\%$$

This is less than 20%

(c) For the purposes of determining the taxable income of any taxpayer, there shall be deducted from the assessable income of such taxpayer the amount of any capital loss realized by the taxpayer in the year of assessment, but to the extent only of either.

(i) the capital loss

(ii) any capital gain realized by the taxpayer in that year of assessment whichever is lesser.

(d) 'Disposal' in relation to an asset means transfer of ownership of an asset by whatsoever means including but not limited to:

sale
gift
bequest
distribution or
exchange

SECTION B

ANSWER THREE QUESTIONS ONLY FROM THIS SECTION

3. (a) (i) It is called double taxation.

(ii) This arises because of:

- differences in bases of taxation in different countries
- some countries use source while others use residence when taxing revenue.

This can be mitigated or prevented by:
- entering in Double Tax Agreements with other countries

- provisions in the Taxation Act, that allows deductions of foreign tax.

(iii) Circumstances under which wife's emoluments may not be treated as wife's earned income are:

(1) When income is not derived in her own right i.e. where husband is the employer or partner.

(2) The emoluments from employment received or accrued to or in favour of the wife where the employer is

- her husband
- a partnership in which the husband is a partner

- a company in which the husband is a director who controls directly or indirectly more than 5% of voting rights attaching to all classes of shares of the company.
- a company in which the wife is a director who controls directly or indirectly more than 5% of the voting rights attaching to all classes of shares of the company and in which the husband is employed or is a director.

(b) (i) Exchange gain or loss on transactions. Calculation of gains or losses:
Formula $ar_1 – ar_2$
Where **a** – amount of foreign currency

r_1 – rate of exchange at the date of establishing liability

r2– rate of exchange at the time of settling the liability

April 2010 Payment

(25000 x 145) – (25000 x 152)
3,625,000 – 3,750,000
Exchange loss (125,000)

October 2010 Payment

(125000 x 145) – (125000 x 150)
18,125,000 – 19,000,000
Exchange loss (875,000)

December 2010 Payment

(200,000 x 145) – (200,000 x 155)
29,000,000 – 31,000,000
Exchange loss (2,000,000)

(ii) The loss is not deductible because it is unrealized.

(c) Annuity income is supposed to be included in the taxable income of a taxpayer.
Excluding: in the case of an annuity which has been purchased, that part of the amount of the annuity which represents the undeducted purchase price.

4. (a) (i) Persons carrying on any trade partnership shall:

- joint return in respect of such trade, together with such particulars as may from time to time be prescribed.

- be separately liable for the rendering of the joint return.
- be liable to income tax only in individual capacities.
- have separate assessments made upon partners.

(ii)

	K'000	K'000
Net profit as per accounts		777
Add back: Depreciation	143 ½	
Salaries	720 ½	
Interest on capital	127 ½	990
		1,767
Less: Capital allowances		
Taxable profits		1,767

Distribution of Profits

	Total	Chiphazi	Chimwendo
	K'000	K'000	K'000
Salary	720	450	270
Interest on capital	127	85	42
Balance 2:1	920	613	307
	1,657	92	619

Taxable income for Chimwendo

Profit	Rental income	
619+	240,000	= 859,000

Tax	On	K859,000			
1st	120,000	@	0%	=	0
Next	36,000	@	15%	=	5,400
Balance	703,000	@	30%	=	210,900
					216,300

(b) (i) There are two main types of clubs and associations which are recognized under the Taxation Act and they are as follows:

Clubs which are formed or are operated solely or principally for
- social welfare
- civic improvement
- other similar purposes
- and which do not distribute any income to members

Those which are formed or operated solely or principally for
- pleasure
- recreation

(ii) Computation of taxable income for Chikolo Sports Club – financial year to 31 December 2009

		K'000
Sale of food		125
Sale of drinks		80
TV shows		140
Live band performances		600
Gambling machines		960
		1,905
6¼% ½ thereon	=	119,062.5

(iii) Tax payable

Taxable income	K119,062.50
Rate applicable 30%	
Amount of tax 119,062.5 x 30% =	35,718.75

(iv) The income will be assessed in the tax year to 30 June 2010.

5. (a) (i) A fringe benefit is <u>any asset, service or other benefit in kind</u> provided by or on behalf of an employer to an employee where such <u>benefits includes an element of</u> personal benefit to the employee.

(ii) Liability to fringe benefits tax arises where an employer provides fringe benefits to an employee.

(iii) An employer who provides fringe benefits to employees is liable to pay the fringe benefits tax.

(iv) Fringe benefits tax is due for payment not later than fourteen (14) days after the end of each quarter.

(b) (i) (1) Employer is liable as the housing allowance is paid to a third party.

(2) School fees will be taxable in the hands of the employee as it is paid directly to him.

(3) Motor vehicle fringe benefit will be taxed in the hands of the employer.

(4) The motor vehicle insurance is not a standalone benefit when paid to a third party. It is a complement on the motor vehicle benefit. No tax therefore arises whether to the employer or employee.

However the amount for running cost which is payable to the employee is taxable in the hands of the employee because it is paid to the employee.

(5) The provision of a cook is a taxable benefit. The burden falls on the employer.

(ii) <u>Motor Vehicle fringe benefit</u>

		K
Cost of the vehicle		5,500,000
Taxable value		15%
∴ 5,500,000 x 15%	=	825,000
Quarterly value	=	206,250
Tax at 30%	=	206,250 x 30%
	=	<u>61,875</u>

(iii) An employer will always provide security to business assets, like a house even without occupation by an employee. Therefore the employee's security is seen as very secondary and therefore ignored.

This is considered equitable because the primary purpose of the expenditure is being recognised.

(c) (i) The imposition of penalties under the Taxation Act is meant to achieve

- compliance by the taxpayers
- the collection of revenue by government
- and enforcement of rules and regulations contained in the Taxation Act.

(ii) In certain circumstances, the taxpayers might not pay the penalties as they will appeal against the penalty and therefore no money will be received.

Some penalties are too low to have the effect of improved taxpayer compliance. Taxpayers will choose not to pay them as they realize that the benefits they get by deliberate non compliance by far outweigh the possible penalties.

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6. (a) (i) One common feature between exempt and zero rated supplies is that VAT is not payable in respect of both supplies.

(i) Main differences are:
- Exempt supplies are not subject to VAT while
- Zero rated supplies are subject to VAT.
- Input tax is not claimable in respect of exempt supplies while

- Input tax is claimable in respect of zero rated supplies.

(b) A taxable supply becomes relief supply when it is made to:

Individuals
Organizations: and businesses specified in the third schedule to the VAT Act.
The user of the goods and services that qualify as relief supply enjoys an advantage that no VAT is payable because of the relief that is given.

(c) A taxable person qualifies for input tax deduction in respect of supply of motor vehicles or motor vehicle spare parts if the taxable person is in the business of:

- dealing in motor vehicles, or
- hiring of motor vehicles; or
- selling of motor vehicle spare parts

However, where the taxable person uses the motor vehicles or motor vehicle spare parts,

- wholly
- exclusively; and
- necessarily for business

Such taxable person shall qualify for input tax deduction in respect of such motor vehicles and motor vehicle spare parts.

(d) (i) VAT on raw materials

Value inclusive of VAT K1,980,500

$\therefore$ VAT $\frac{1{,}980{,}500 \times 100}{116.5}$ = 1,700,000

VAT inclusive value	1,980,500
VAT exclusive value	1,700,000
VAT =	K280,500

(ii) Amount of output VAT

No output tax on exports

output tax on local sales:		3,400,000
rate of VAT 16½%		
$\therefore$ VAT	=	561,000
Total value		3,961,000

Total VAT therefore is

VAT on exports	=	0
VAT on local sales	=	561000
		K561000

(iii) Output VAT total on both local and exports 561,000

Less input VAT:

on telephone	37125	
on electricity	12375	
on security charges	56100	
on stationery	14025	
on rentals	74250	
on raw material	280500	474375
Net VAT payable		86,625

7. (a) (i)

Rent payable		655,500
Withholding tax rate given		10%
$\therefore$ Expected withholding tax		655,500 x 10%
	=	65,550

No, it was not correctly operated as he was supposed to have been

deducted K65,500 but only K55,000 was withheld.

Penalties

There are penalties applicable to the tenant and not the landlord these are:

- failure to deduct tax makes one personally liable to pay the tax which was not withheld; plus 20% additional tax if paid late.

- failure to operate a withholding tax scheme makes one guilty of an offence punishable by a fine of K1,000.

(ii) Penalties for under deduction of PAYE are:

- 20% of the tax payable
- and a further additional 5% per month or part thereof as it remains unpaid.

(iii) Income tax computation

		K'000
Rent received		655
Salary received		7200
		7855
Less:		
Rates	45	
Interest	140	
Donations	10	
Subscription	75	270
		7585

Tax payable

Tax payable as given		2,234,100
Less : withholding tax	55,000	
PAYE tax	2,000,000	2,055,000
Net tax payable		179,100
Tax on assessment		725,240
Tax over-estimated		546,140

(b) (i) Research and Experiments

The expenditure should not be of capital nature.

The expenditure must be on experiments and research relating to the trade of the taxpayer.

(ii) Bad debts

These may be allowed as a deduction where the debt has become bad and therefore irrecoverable, during the year of assessment for various reasons.

The Commissioner must be satisfied that the debt has become bad.

The amount of the debt must have been included in the income of the taxpayer either for the current or previous year of assessment.

(iii) Doubtful debts

The doubtful debt may be allowed as a deduction if the debt is in respect of a specific debtor where chances of recovery are uncertain.

The amount of the debt must have been included in the income of the taxpayer for the current year or previous year of assessment.

Any doubtful debt allowed as a deduction in one year of assessment must be included in the income of the taxpayer for the following year of assessment.

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